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Industrial Concentration: The New Learning, by Harvey J. Goldscmid, H. Michael Mann & J. Fred Weston, and Conglomerate Enterprise and Pubic Policy, by Jesse W. Markham

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BOOK REVIEW

INDUSTRIAL CONCENTRATION: THE NEW LEARNING. Edited by Harvey J. Goldschmid, H. Michael Mann & J. Fred Weston. Boston: Little, Brown & Company, 1974. Pp. viii, 470. $5.95.
CONGLOMERATE ENTERPRISE AND PUBLIC POLICY. By Jesse W. Markham. Boston: Division of Research, Harvard Business School, 1973. Pp. xviii, 218. $9.00.

Neither the impassioned petitions from environmentalists soliciting suspension of enforcement nor the alleged machinations of the giant oil companies have replaced conglomeration as the ultimate stress on antitrust. It is a subject that has triggered an outpouring of advice and moralizing from every conceivable source. Much of the literature can be dismissed as result oriented or vacuous. (One wonders how many professors caught in the "publish-or-perish" corner avoided academic demise by producing a few quickies on conglomeration.) There is, however, a pocket of serious students of the phenomenon who produce high quality papers. Jesse Markham's *Conglomerate Enterprise and Public Policy*[1] falls into the latter category.

The government stands on one side of the controversy as the architect of an aggressive enforcement campaign based on the assumption that the prophylactic stretch of section 7 of the Clayton Act accommodates four possible anticompetitive consequences of conglomeration: (1) structural relationships conducive to reciprocity can result, (2) the acquired firm can derive advantages over rivals from "deep pocket" subsidizing by the acquirer, (3) the acquirer can eliminate itself as a potential competitor standing at the edge of the market, and (4) aggregate concentration can be enhanced. The government's reasoning constitutes the fashionable wisdom of the majority.

A counterculture of dissent perceives unyielding static between the scope of Clayton 7 and a form of merger that does not, at least in the short run, alter the market share statistics of the firms. Acknowledging that in some cases it may be possible to discern adverse effects, the *Neal Report* nevertheless cautions that "existing

1. J. MARKHAM, CONGLOMERATE ENTERPRISE AND PUBLIC POLICY (1973) [hereinafter cited as CONGLOMERATE ENTERPRISE].

knowledge provides little basis for forecasting adverse effects on competition that support application"[2] of the Clayton Act. The *Report* further advises that forcing the antimerger act on the enigmas of conglomeration is likely to pressure the courts into speculation or outright value judgments.[3] Representing a different philosophical base, the *Stigler Report* is equally skeptical that conglomeration fits into the antitrust mold, concluding that the main complaints about the conglomerate relate to other things.[4]

The difficulty in quantifying competitive effects has pushed the controversy to the a priori level. In a "battle of the little black boxes," economists compete in turning out theoretical models. Intuition is rebutted by speculation. Professor Markham's study knifes through the clouds to grapple with facts and in the process puts in question the credibility of the government's list of charges.

Markham notes that the purported evil genius of the conglomerate system is the synergistic effect of 2+2=5; hence, "a firm having a 10 percent share of a dozen or so markets . . . actually possesses greater market power in each of these markets, say the equivalent of 15 percent . . . ."[5] A second alleged advantage is the "special capacity" to coordinate the behavior of the diversified satellites so as to achieve an edge that cannot be duplicated by "independent" single-product firms. The first advantage cannot, according to Markham, be empirically tested and is, in any case, subsumed in the second factor. "Ultimately, therefore, whatever distinctive market power conglomerate firms may possess must derive from the business tactics and strategies their intermarket structure makes available to them rather than from their share of particular markets."[6] Specifically, do conglomerates engage in the practices of reciprocity, cross-product subsidization, and predatory pricing?

Markham contends that the answer to this question can be found

2. P. NEAL, REPORT OF THE WHITE HOUSE TASK FORCE ON ANTITRUST POLICY, 115 CONG. REC. 13890, 13894 (1969). The "gap" in § 7 of the Clayton Act was one of the factors that prompted the Task Force to recommend a form of statutory deconcentration. *Id.*

3. *Id. See also* Austin, *Conglomerate Merger: A New Source of Antitrust Tensions*, 21 CASE W. RES. L. REV. 181, 194-201 (1970).

4. G. STIGLER, PRESIDENTIAL TASK FORCE, REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 15933 (1969); Coase, *Working Paper for the Task Force on Productivity and Competition*, 115 CONG. REC. 15938 (1969). The *Stigler Report* expressly repudiated proposals for new legislation to deal with the conglomeration problem. G. STIGLER, *supra* at 15933.

5. CONGLOMERATE ENTERPRISE 60.

6. *Id.*

by studying the manner in which the organizational chart of the firm influences its conduct. Forms of conduct, like reciprocity and subsidization, are the consequence of a deliberate decision to allocate enterprise resources among the member firms so as to achieve specific goals. At any given instant, conglomerate firm resources are finite; thus, the act of shifting resources means that some of the member firms are likely to gain at the sacrifice of others. Given these constraints, optimum benefits from intraconglomerate exchanges can be achieved only under an organizational structure that imposes on constituent firms centralized and coordinated decisionmaking.

It follows that decisionmaking autonomy at the division level renders reciprocity and subsidization unlikely while centralization raises a positive inference. "It is highly unlikely . . . that a division given complete autonomy over its pricing policy will compromise its own financial performance in order to subsidize another autonomous division's product. Moreover, divisional autonomy, when combined with profit-center accounting and control, and a system of managerial rewards based on financial performance, is an impediment to the practice of reciprocity and cross-product subsidization across divisions."[7]

A statistical summary of 211 firms revealed that lines of managerial responsibility function so as to refute the inference of subsidization and reciprocity. As to three key indicators, the extent of decisional autonomization was found to be high: 71 percent of firms delegated to divisions the power to make price decisions, 65 percent delegated advertising authority, and 55 percent left research and development decisions at the division level.[8] Looking at only acquired firms, the extent of delegation was higher. Markham also discovered that the incidence of trade relations department operations—thought to be highly "suggestive" of reciprocity—was low: only 16 percent of responding firms maintained such departments.[9]

By self-admission, Markham throws only "modest light" on the potential competition problem.[10] His statistics cut at the underpinnings of the assumption that if denied entry by acquisition, diversifiers will enter the same market de novo. In only 79 of 745 diversifying acquisitions did the firms first consider de novo entry as a viable alternative. He concludes that "in by far the vast majority

7. *Id.* at 171.
8. *Id.* at 69.
9. *Id.* at 78.
10. *Id.* at 125.

of cases of conglomerate acquisition the acquiring firm is not a potential competitor lurking on the border of the acquired company's market, seriously contemplating entry by the internal expansion route."[11]

Finally, Markham concludes that conglomeration has thus far not adversely affected market structure. Increases and decreases in concentration in three- and four-digit SIC industries have balanced out.[12] When the government's sociopolitical anticonglomerate argument that conglomeration enhances aggregate concentration was put to the test of factual verification, the same result emerged: "the conglomerate merger wave appears to have had no measurable effect on the overall structure of the manufacturing economy."[13]

Convinced that in fact diversified firms function no differently than undiversified firms, Markham repudiates resort to a "special antitrust policy." The proper target, reachable under present standards, is "intolerable market power without special regard to the product diversity of its corporate residence."[14]

The dilemma confronting all who deal in the cryptology of conglomeration is the inability to establish a solid empirical position that would end the bickering and lead to a consensus on policy. Markham does not make a clean break out of the dilemma. He has compiled a convincing study that effectively counters the faddish 2+2 =5 conglomerate math; he does not, however, completely rout the opposition. His conclusions on conglomerate behavior are couched in terms of inferences derived from statistics describing the allocation of decisionmaking authority. Given the lacuna between probable managerial strategy and what firms in fact do, that large body of critics who have a heavy investment in their own conglomerate portfolio are not likely to give Markham's study the credit that it deserves.

Critics can also avoid the thrust of his findings on concentration by pointing to the short time frame of the study and noting that the deleterious effects of the conglomerate wave are too subtle to cause short-run ripples in market structures. This is a reasonable criticism; as Markham acknowledges, the length of time necessary for a reliable reading is an issue over which reasonable men will differ.[15]

11. *Id.* at 126.
12. *Id.* at 169.
13. *Id.*
14. *Id.* at 177.
15. *Id.* at 175.

The more zealous addicts of the "outer limits" use of Clayton 7 will simply ignore the study. This faction of the establishment considers proscription appropriate whenever an acquisition creates a structural opportunity to engage in subsidization or reciprocity. It is the potential for the opportunity that constitutes the violation. Hence a study like Markham's that endeavors to get a fix on the past and the present so as to project reality is irrelevant to those who develop policy based on horoscopes of the intentions lurking deep in the management psyche.

Digging into the lacuna between inference and fact nourishes the economist's intellect and wallet. Books, papers, and studies issue forth that either detail the proper method for confirming assumptions or that describe a slice of reality purportedly in line with theoretical formulation. *Industrial Concentration: The New Learning*[16] is a product of this eternal commitment. During 1974, a group of economists and lawyers met to discuss the state of the empirical support for the structure-conduct-performance model. At issue was the extent and the quality of the influence that market concentration exerts on economies of scale, advertising, profits, innovation, and inflation.

Most of the nation's big names in industrial organization economics had their say in a debate format. Scherer concludes that scale economies exist but are "exhausted at relatively modest concentration levels in many manufacturing industries . . . ."[17] McGee counters that most of the studies on economies are incomplete, "at least as likely to mislead as to inform."[18] As to advertising, Yale Brozen says that it increases competition, that there is "indirect evidence whose weight leans toward the conclusion that advertising increases elasticity."[19] Mann disputes this, contending that theory suggests a positive relationship between advertising, oligopoly, and high profits. He adds: "The evidence favors the theorizing, although the exact cause and effect linkages among the variables eludes a priori argument at present, and empirical work as a tool for discriminating among alternative theories has barely begun."[20] On the issue of

16. INDUSTRIAL CONCENTRATION: THE NEW LEARNING (H. Goldschmid, H. Mann & J. Weston eds. 1974) [hereinafter cited as INDUSTRIAL CONCENTRATION].

17. Scherer, *Economics of Scale and Industrial Concentration*, in INDUSTRIAL CONCENTRATION 16, 51-52.

18. McGee, *Efficiency and Economies of Size*, in INDUSTRIAL CONCENTRATION 55, 68.

19. Brozen, *Entry Barriers: Advertising and Product Differentiation*, in INDUSTRIAL CONCENTRATION 115, 130.

20. Mann, *Advertising, Concentration, and Profitability: The State of*

whether concentration and firm size are necessary to support innovation, the ubiquitous Jesse Markham observes that the evidence is inconclusive and cautions that on "a purely academic level, no professor of industrial organization could justify dismissing lightly the Schumpeterian alternative theory of industrial behavior on the grounds that it flies in the face of the available factual evidence."[21] Mueller contends that concentration feeds inflation;[22] Weston and Lustgarten combine to repudiate and label false the "popular generalization about the positive relation between concentration and price increases."[23]

The most critical debate centers on the cornerstone assumption that high concentration produces poor performance in the form of supracompetitive prices. Weiss summarizes 46 studies, concluding that a positive connection between concentration and profits confirms the theoretical assumptions on the linkage between structure, conduct, and performance.[24] Demsetz' treatment is two-pronged; he contends that for various reasons relating to methodology, the structuralist studies stand discredited. His other argument is that by using the oligopoly behavior models to mirror single-firm monopoly theory, the structuralists have appropriated into their model the same defect that self-destructs the monopoly model—both models assume that monopoly power exists, but do not explain how such power is acquired and maintained.[25]

Throughout the debate, the "truths" of the "new learning" are muffled from either the cacophony of competing empirical studies or the smoke that swirls around the nit-picking guerrilla warfare over methodology. This is not to suggest that the overall influence of structuralism is neutralized by countervailing views. While the editors of the book have compiled a balanced presentation of opposing views, in the actual world of microeconomics, the majority of the population is composed of structuralists.

Knowledge and Directions for Public Policy, in INDUSTRIAL CONCENTRATION 137, 155.

21. Markham, *Concentration: A Stimulus or Retardant to Innovation?*, in INDUSTRIAL CONCENTRATION 247, 267-68.

22. Mueller, *Industrial Concentration: An Important Inflationary Force?*, in INDUSTRIAL CONCENTRATION 280.

23. Weston & Lustgarten, *Concentration and Wage-Price Change*, in INDUSTRIAL CONCENTRATION 307, 330.

24. Weiss, *The Concentration-Profits Relationship in Antitrust*, in INDUSTRIAL CONCENTRATION 184.

25. Demsetz, *Two Systems of Belief About Monopoly*, in INDUSTRIAL CONCENTRATION 164.

The structuralists have not relied on a mere superiority in numbers to overcome the various weaknesses in their studies or to blunt the efforts of the opposition. They have instead proselytized the "truths" of abstract models, and shoved to the background the debate over the crevices and leaks in the empirical studies. The most impressionable disciples of the campaign have been the antitrust enforcement agencies and the judiciary. With perception, government lawyers recognized the advantages to be gained by engulfing an unfathomable fact situation under the blanket of an a priori model whose assumptions on competitive effects fall within the sweeping antitrust proscriptive standards. The intercourse between oligopoly theory and the "probability" standard of Clayton 7 has been particularly productive. By theoretical pronouncement, oligopoly breeds poor competitive conditions: thus a merger producing oligopoly is proscribable as demonstrating a "probability" of a lessening of competition. Not content with the sweep of this approach, the Justice Department argued in *U.S. v. Von's Grocery Co.*,[26] that oligopoly has no lower limits, thus *any* merger contributes to oligopoly and is, by implication, proscribable.[27]

The courts have been the third-party beneficiaries of the government's "new learning." Economic theory is especially seductive to trial judges, to whom the antitrust case and the accompanying "enormous, nearly cancerous growth of exhibits, depositions, and *ore tenus* testimony"[28] are anathema. Unintelligible testimony and carloads of documents become less burdensome when economic theory is available for tutoring. Most importantly, the assumptions of theory give the courts a manageable set of presumptions. Thus, once the facts confirm an oligopoly structure, the court presumes adverse effects.[29]

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26. 384 U.S. 270 (1966).

27. It is no answer to say that a merger need not be forbidden unless it actually creates oligopoly. For there is no magic point at which oligopoly springs full-blown into existence. Between the highly fragmented and the tightly concentrated market structure there is a middle area, one broad part of which is certainly a danger zone. No one can say—at least not without an inquiry far broader and deeper than practical law enforcement permits—at precisely what point a particular market will exhibit oligopolistic behavior. It is thus meaningless to speak of allowing firms to merge up to the lower limit of oligopoly; practically speaking, that limit is unascertainable.

Brief for Appellant at 23, United States v. Von's Grocery Co., 384 U.S. 270 (1966).

28. United States v. Grinnell Corp., 236 F. Supp. 244, 247 (D.R.I. 1964).

29. FTC v. Procter & Gamble Co., 386 U.S. 568, 595 (1967) (Harlan, J., concurring).

As the Markham book suggests, structural theories have achieved the greatest success in the hostilities against conglomeration. Indeed, it can be said that from the conglomerate campaign evolved the Principle of Antitrust Inversity: the less the ability to confirm or ascertain the facts of competitive injury, the greater the reliance on economic theory.

In broad context, the Principle of Antitrust Inversity is compatible with the lifestyle of the "postindustrial society." In today's postindustrial system, planning is the critical factor in achieving and maintaining success.[30] The brute size of the typical enterprise, the heavy capital investment, and a generous commitment to research and development put the mark of disaster on errors of judgment. Effective planning is enhanced by the development of sophisticated management techniques and the remarkable advances in technology. It is technology, however, that generates the contradiction. At near exponential rates technology produces, absorbs, and renders obsolete great quantities of facts. Computers spew out "empirical" studies—and counterstudies. The consequence is that technology both enhances and obstructs planning. The contradiction is resolved by resort to the theoretical model, and the industrial planner, like the judge, looks to theory to manage facts and convert system out of chaos. "What has become decisive for the organization of decisions and the direction of change is the centrality of *theoretical* knowledge—the primacy of theory over empiricism and the codification of knowledge into abstract systems of symbols that . . . can be used to illuminate many different and varied areas of experience."[31]

The New Learning concludes with a debate over reform. The committed structuralist holds statutory deconcentration to be the

30. Planning exists because [the market] process has ceased to be reliable. Technology, with its companion commitment of time and capital, means that the needs of the consumer must be anticipated—by months or years. When the distant day arrives the consumer's willingness to buy may well be lacking. By the same token, while common labor and carbon steel will be forthcoming in response to a promise to pay, the specialized skills and arcane materials required by advanced technology cannot similarly be counted upon. The needed action in both instances is evident: in addition to deciding what the consumer will want and will pay, the firm must take every feasible step to see that what it decides to produce is wanted by the consumer at a remunerative price. And it must see that the labor, materials and equipment that it needs will be available at a cost consistent with the price it will recieve. It must exercise control over what is sold. It must exercise control over what is supplied. It must replace the market with planning.

J. GALBRAITH, THE NEW INDUSTRIAL STATE 23-24 (1967).

31. D. BELL, THE COMING OF POST-INDUSTRIAL SOCIETY 20 (1973).

remedy, with the Kaysen-Turner proposal,[32] the *Neal Report*,[33] and the Hart bill,[34] serving as models. At this point a switch in tactics occurs; the structuralist self-transforms into the political economist and cites sociopolitical value judgments as justifications for the deconcentration program. The prospect of political and social tyranny by the giant corporation along with other indictments from the days of Senator Sherman are uncorked to justify drastic surgery. Thus, in the showdown, the structuralist acknowledges that the state of knowledge in the field of microeconomics is too unsettled and too underdeveloped to resolve conclusively the doubts over the tradeoffs from deconcentration.

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32. C. KAYSEN & D. TURNER, ANTITRUST POLICY 265-72 (1959).

33. The Concentrated Industries Act, in P. NEAL, *supra* note 2, at 13897, *reprinted in* INDUSTRIAL CONCENTRATION 449.

34. The Industrial Reorganization Act, S. 1167, 93d Cong., 1st Sess. (1973), *reprinted in* INDUSTRIAL CONCENTRATION 444.

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